



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

DEC 15 1981

F. G.

MEMORANDUM FOR MAURICE ERNST
NATIONAL INTELLIGENCE OFFICER FOR ECONOMICS
CENTRAL INTELLIGENCE AGENCY

SUBJECT: CCEA Working Group on LDC Financial Problems

Marc Leland and Bob Hormats, who co-chair the CCEA Working Group on LDC Financial Problems, have agreed that CIA should be involved in the activities of this Group. One of the initial activities was the preparation by Treasury staff of a "Background Paper on LDC Debt". A copy is enclosed, and we would like to receive CIA's comments on this draft by December 18 so that we can have it ready to transmit to the CCEA in early January. Your comments can be sent to me or to Lex Rieffel (Room 5413, M.T., 566-8703).

In addition, I am enclosing a copy of the memo from Roger Porter establishing the Working Group on LDC Financial Problems, and a memo summarizing highlights of the Group's first meeting. We also need to know the name of the individual you will designate to represent CIA at future meetings of the Working Group.

Thomas C. Dawson

cc: Elinor Constable
Roger Porter, CC

Background Paper on LDC Debt: revised
20 January 1982



**Department of the Treasury
Washington, D.C. 20220**

MEMORANDUM

Date: 9 December 1981

To: The Files

From: Alexis Rieffel

Subject: 3 December 81 Meeting of CCEA WG on LDC Financial Problems

A. Introductory Comments

LELAND: Opened meeting with a request for comments from Working Group members on the "Background Paper on LDC Debt" prepared by Treasury staff.

HORMATS: After "comparable treatment", the most important issues are: (a) participation of MDBs in rescheduling operations; (b) alternative approaches to debt relief in "prolonged" cases; (c) role of the IMF as a monitor and IMF borrowing arrangements as a precondition for relief from official creditors; and (d) interest rates charged by USG agencies on rescheduled debt.

BAILEY: Three things missing in draft paper at this stage: (a) analysis of debt situation in East Europe; (b) budget impact of "alternative futures"; and (c) impact on banking system under different scenarios of collapse, identifying countries and assigning probabilities to events.

PORTER: This WG serves three purposes:

- (a) an "early warning mechanism" for Cabinet-level policy-makers;
- (b) educate Cabinet-level and other senior officials on current and emerging problems; and (c) put forward specific policy recommendations/options for Cabinet-level decision.

B. Discussion

1. "Comparable Treatment" and Role of Commercial Banks

-- (Leland) We will work on memo to the CCEA on comparable treatment and send it out soon. (Treasury Office Concerned: IDN, IMB)



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- (Leland) Interrelationship of private and public sectors in foreign lending is quite different in the U.S. and in other G-5 countries. Different banking structures/systems lead to different policies. Should explore this. Need to look at banking laws. Consider to what extent USG wants to get involved in debt relief by banks. European governments can do things for their banks (subsidies, commissions, deposits, etc.) that USG cannot do. Would never get honest answers from Japan (or France) if we asked for explanation. I will ask Treasury attaches to submit reports on this. We agree on arms-length relationship but what should USG do when there is evidence that banks are being over-eager or too nervous. (Treasury Office Concerned: IMA, IMB)
 - (Hormats) Get the IMF to update the study they did a few years ago showing that bank exposure has increased after countries have concluded IMF arrangements. (IMA)
 - (Bailey) Important to distinguish between leaning on the banks for political reasons and talking with them about prudential/regulatory concerns.
 - (Bailey) Need information on "bunching" of maturities for countries that might collapse. (IMB, IDN)
- 2. East European Debt Situation**
- (Leland) Need to examine the whole East European situation on a "separate track". This should include role of IMF. This is most timely issue. (ITE, IMA, IMB)
- 3. MDB Participation in Rescheduling Operations**
- (Farrar) Agree with State that MDB participation issue is good one to pursue. (IDB, IDN, IMB)
 - (Burnham) Need to focus on commercial bank co-financing with MDBs, which raises questions about whether the MDBs should continue to enjoy preferred status over the banks which participate in co-financing arrangements.
- 4. Early Warning Mechanism**
- (Leland, responding to Porter's request for an early warning mechanism). Don't want to classify countries as the Comptroller of the Currency does. Country situations (e.g., Brazil) evolve rapidly. Might do periodic reports to the CCEA on debt issues that are surfacing like Zaire and rescheduling previously rescheduled debt. (IDN)

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-- (Hormats) Periodic reports should also identify countries like Brazil where there are issues across the board (trade, aviation, etc.)

-- (Farrar) Periodic report could also identify budget impact.

5. Other Matters

-- (Leland) Need comments from WG members on Background Paper so it can be put in final form. (Treasury Office Concerned: IDN)

-- (Bailey) CIA should be invited to participate in WG. (Leland and Porter agreed. There was also agreement that the Federal Reserve should be involved in some discussions.) (IDN)

-- (Anderson) Need to examine central bank swap arrangements. (IMA)

-- (Leland) We will do a summary of our work program. (IDN)

C. List of Participants

Treasury:	Marc Leland Tom Dawson Charles Dallara Lex Rieffel	CCEA: Roger Porter Doug Anderson Eric Hemel
State:	Bob Hormats Elinor Constable John Dawson	NSC: Norman Bailey CEA: Jim Burnham OMB: Steve Farrar

DISTRIBUTION: Participants, plus T. Leddy, B. Newman, J. Ammerman, N. Jacklin, D. Templeman, F. Maresca, J. Hartzell, R. Cornell, S. Canner

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THE WHITE HOUSE

WASHINGTON

September 24, 1981

MEMORANDUM FOR THE SECRETARY OF STATE
THE SECRETARY OF THE TREASURY
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS
THE ASSISTANT TO THE PRESIDENT FOR NATIONAL
SECURITY AFFAIRS
THE ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT

SUBJECT: The Cabinet Council on Economic Affairs Working Group on LDC Financial Problems

A memorandum establishing a Cabinet Council on Economic Affairs Working Group on LDC Financial Problems is attached. It is expected that departmental and agency representatives to the working group will be at the Assistant Secretary level or above.

I would appreciate very much you communicating to my office the name of the individual you wish to represent you on the working group by close of business on Tuesday, September 29.

Roger B. Porter
Roger B. Porter
Executive Secretary

Attachment

WASHINGTON

September 24, 1981

MEMORANDUM FOR THE SECRETARY OF STATE
THE SECRETARY OF THE TREASURY
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS
THE ASSISTANT TO THE PRESIDENT FOR
NATIONAL SECURITY AFFAIRS
THE ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT

SUBJECT: The Cabinet Council on Economic Affairs Working Group on LDC Financial Problems

The foreign indebtedness of developing countries has grown rapidly during the past decade, rising from approximately \$90 billion in 1972 to \$416 billion at the end of 1980. This indebtedness includes \$154 billion in public debt owed foreign official creditors and \$262 billion in public debt owed foreign private creditors. Since the early 1970s the composition of new borrowing has shifted from official sources toward private sources. This shift has contributed to a significant hardening in the terms of new commitments by means of shorter maturities and higher interest rates.

These developments have occurred at a time when the terms of trade for the non-oil developing countries have deteriorated and demand for their exports has softened. Twelve developing countries (Bolivia, Central African Republic, Jamaica, Liberia, Madagascar, Nicaragua, Poland, Sierra Leone, Sudan, Togo, Turkey, and Zaire) are currently receiving debt relief from official and/or private creditors. Two or three additional countries will likely seek relief during the next year, and a number of others have accumulated substantial payment arrears.

As of 31 March 1981, U.S. Government exposure vis-a-vis developing countries was approximately \$45 billion in direct credits plus \$13 billion in contingent liabilities (i.e. government guarantees) on loans and investments extended by private lenders. Arrearages on direct credits including short-term credits and accounts receivable were \$1.0 billion. However, \$830 million of this amount related to extraordinary political arrearages including those of Vietnam, Cuba, China, and Iran, and Korean War Logistical Support debts. For all practical purposes the latter debts are uncollectible at this time. This leaves approximately \$170 million of arrears on direct creditors.

These arrearage figures understate the impact of the LDC debt-servicing difficulties because they do not include rescheduled payments. Treasury estimates that foregone debt receipts in FY 1982 due to debt

relief arrangements already concluded (e.g. Turkey, Poland, Pakistan, Zaire) and additional debt relief which has been requested or seems imminent (e.g. Liberia, Senegal) will approach \$920 million. (The \$1.0 billion in arrears mentioned above is separate from this total). Receipt shortfalls of this magnitude represent a significant drain on the budget.

The U.S. Government has not undertaken a broad review of the LDC financial problems for at least a decade. Yet, the subject has important implications for U.S. foreign policy objectives in specific countries, for U.S. efforts to strengthen the global economy, for the roles of the IBRD, the IMF and private banks, for the U.S. budget, and for the management of the various U.S. foreign credit programs.

The Chairman Pro Tempore of the Cabinet Council on Economic Affairs has approved establishing a Cabinet Council Working Group on LDC Financial Problems to assess current and prospective debt-servicing and other financial problems among the LDCs and the implications for U.S. policy. The working group will consist of representatives from the Departments of Treasury and State, the staff of the National Security Council, the Office of Management and Budget, the Council of Economic Advisers, and the Office of Policy Development. The group will seek advice and information from the Departments of Agriculture, Commerce, and Defense, the Agency for International Development, the Overseas Private Investment Corporation, the Export-Import Bank, and the Federal Reserve Board as appropriate. The Assistant Secretary of the Treasury for International Affairs and the Assistant Secretary of State for Economic and Business Affairs will co-chair the working group.

The working group's review should include, but not be limited to:

1. Identifying countries where U.S. exposure (official and private) is heavy and where the risks of payment interruptions in the next 12-18 months are significant;
2. Examining the impact of payment interruptions and debt relief on the budget, including congressional aspects of the problem;
3. Evaluating the impact of LDC debt difficulties on U.S. interests in promoting economic growth in politically-important countries, in assuring the growth and stability of the international financial system, and in fostering effective collaboration between the IBRD and the IMF, (including, specifically, the issue of the multilateral development banks' participation in debt relief operations);

4. Reviewing existing U.S. Government policies and procedures for minimizing delinquencies on foreign debt and for protecting U.S. financial interests in default situations including specific recommendations for dealing with "extraordinary political" arrearages; and
5. Formulating recommendations for improving policies and procedures of the U.S. Government relating to LDC debt for review by the Cabinet Council and the National Advisory Council on International Monetary and Financial Policies (NAC).

The working group chairman should work closely with the Executive Secretary of the Council in developing the sequence of issues the working group will consider and in scheduling presentations to Council meetings.

Roger B. Porter
Roger B. Porter
Executive Secretary